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Audit Report Lag and the Effectiveness of Audit Committee Among Malaysian Listed Companies

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Abstract

The purpose of this study is to examine the link between audit committee characteristics and audit report lag among 288 companies listed at Bursa Malaysia for a three year period from 2007 to 2009. The characteristics of audit committee examined are audit committee independence, audit committee diligence and audit committee expertise. In this study, audit report lag refers to the number of days from the company's year end (financial year) to the date of auditor's report. The results of this study show that audit report lag for the listed companies in Malaysia ranges from 36 days to 184 days for the three year period. The results of this study also show that audit committee independence and audit committee expertise could assist in reducing audit report lag among companies in Malaysia. This study however could not provide any evidence on the link between audit committee diligence on audit report lag. Overall, the findings in this study provide some evidence supporting the resource based theory, whereby characteristics of the audit committee as the resources and capabilities could improve companies' performance as well as corporate reporting.

Keywords: Audit Committee, Audit Report Lag

1. Introduction

Financial reporting in general will provide useful information and assist users in decision making as capacity of capital providers in companies. Particularly users rely on the audited financial reports in their assessment and evaluation of companies' performance. The audited financial reports will increase its reliability and users will feel affirm on the reports verified by the auditors and would be able to make decision wisely (FASB, Concepts Statement 2).

Timeliness itself will enhance the usefulness of the information. There are many ways to define timeliness. Commonly known that timeliness is the reporting delay from the company's accounting year end to the date of the audit report completed (Chambers and Penman, 1984). Audit report lag would lead the shareholders and potential shareholders to postpone their transaction on shares (Ng and Tai, 1994). This in turn, would provide negative effect to the company.

Bursa Malaysia[1] has demanded for timely financial reporting through the provision of Chapter 2 and Chapter 9 of the Listing Requirements (2009), Bursa Malaysia Securities Berhad. Bursa Malaysia listing requirement under chapter 9.23 (a) provides that a public listed companies must submit its annual report to Bursa Malaysia within six months after the company's year end. To prevent companies from late submission of their audited financial reports, Bursa Malaysia in consultation with Securities Commission has imposed penalty to public listed companies for failure to disclose the material facts such as the annual report within the time frame. However, despite the penalty being imposed, there are companies that could not meet the submission deadline. This current scenario as reported in Bursa Malaysia website 2010 (www.bursamalaysia.com).

Many professional and regulatory bodies have taken various actions to identify the factors that hinder companies in delaying the submission of financial reports. Bursa Malaysia highlighted that corporate governance mechanisms which is audit committee would play a significant role in the company to ensure that the objective of Bursa Malaysia on timely reporting can be achieved. The amended Bursa Malaysia Listing requirement in 2009 provides that the members of audit committee must not be less than 3 persons. All members of the audit committee must be non-executive directors, with a majority of them being independent directors and at least one member is a member of the Malaysia Institute of Accountants (MIA). If the member of the audit committee is not a member of MIA, the member must have at least three years of working experience.

Malaysian Government has recommended Malaysian Code on Corporate Governance (MCCG, 2000) which was later revised in 2007. The revised code recommends that member of audit committee to comprise of fully non-executive directors, be able to read, analyse and interpret financial statements. This is to ensure that they would be able to effectively discharge their functions. Since audit committee has a close working relationship with external auditors, the audit committee would able to assist the level of audit coverage and assurance. This could be done by employing knowledgeable members in the audit committee (Abbott et al. 2003), thus, would improve timeliness and reduce audit report lag.

Past studies that have examined the determinants of audit report lag among companies focused only on company's specific variables such as company size, (Al-Ajmi, 2008), profitability (Ahmad and Kamarudin, 2003), year end (Ahmed, 2003); leverage (Owusu-Ansah and Leventis, 2006), industry type (Jaggi and Tsui, 1999), audit opinion (Ng and Tai, 1994), and type of auditor (Afify, 2009). However, these studies did not examine corporate governance mechanisms in relation to audit report lag.

Afify (2009) and Tauringana (2008) examined the impact of corporate governance mechanisms on audit report lag. Both studies were conducted in a non-Malaysian setting. Within the Malaysian context, studies that have examined the issue of timeliness using firm's specific variable include those by Ahmad and Kamarudin (2003) and Che-Ahmad and Abidin (2008). These two studies did not examine the issue of timeliness in relation to corporate governance mechanism. The current study extends the corporate governance literature by examining the issue of timeliness of annual reports in the Malaysian market by incorporating corporate governance, firm's specific variables in relation to audit report lag.

The aim of the current study is to examine whether the existence of audit committee could assist in reducing audit report lag. Such examination is important since the audit literature has identified the role of audit committee in reviewing the financial statement. This study aims to answer the following research question: "Could audit committee play an important role in effectively monitoring the timeliness of audit report?

This study contributes to the corporate governance and audit literature by examining association of corporate governance; audit committee and the audit report lag. The findings of the study would have policy implications for MCCG. It provides supporting evidence on whether the development of corporate governance could significantly increase the timeliness of annual reports among companies in Malaysia. This study could assist Malaysian Institute of Corporate Governance

[1] Bursa Malaysia was previously known as Kuala Lumpur Stock Exchange.

(MICG) to provide best practice in order to enhance corporate governance mechanisms. The findings could also assist external auditors in evaluating the effectiveness of the audit committee in their audit planning. Such assistance would assist the external auditors in identifying the best time to be allocated for their audit engagements in terms of effort such as whether to reduce or increase effort and the amount of fees to be charged.

The remainder of the paper is organized as follows. First, it discusses on literature review and hypotheses development. Next, it describes on research design to conduct the study. It further provides the results of the analysis and discussion. The final part concludes and provides suggestions for future research.

2. Literature Review and Hypotheses Development

Within the corporate governance mechanisms, audit committee plays an important role in the monitoring process as well as its reporting role in companies. These members would reduce auditors' task complexity and increase timeliness. Therefore, arguably, audit committee would be able to reduce audit report lag. This is because the appointment of audit committee are in line with the agency theory (Jensen and Meckling 1976) where agents act on behalf of principles in ensuring the company is performing well and provides quality annual reporting.

The following sections develop three hypotheses to meet the objectives of the study which are related to the characteristics of audit committee.

2.1. Audit Committee Independence

According to the agency theory, the independent members in audit committee could help the principals to monitor the agents' activities and reduce benefits from withholding information. This is because audit committee with more independent directors is considered as being a more reliable group other than board of directors in monitoring the company. The effective role provides by audit committee would be appropriate to represent the rights and privileges for all stakeholders.

An independent audit committee enhances the effectiveness of monitoring function since it serves as a reinforcing agent to the independence of internal and external auditors in a company. Menon and Williams (1994) posits that an audit committee must comprise entirely of independent directors in order to be more effective. Klein (2002) shows that independent audit committees reduce the likelihood of earnings management, thus improving transparency. Carcello et al. (2000) found that audit committee independence have positive significant relationship with audit fees. This provides evidence that independence of the audit committee would lead to higher quality of financial report.

Further, Ismail et al. (2008) found that the independence of audit committee would not influence the quality reporting of the companies. They argue that this is due to the companies only fulfilling the requirements, rather than the impact of the requirements. In contrast, Ali Shah et al. (2009) found that companies in Pakistan are having good corporate governance through having independence of audit committee.

Bursa Malaysia Listing requirements (2009) and MCCG (2007) have highlighted that the audit committee might institute stronger internal control and good monitoring of financial reporting process in a company. The strong internal control managed by audit committee would lead to auditors reducing their work on the company's accounts because of their reliance on the internal control of the company. This would subsequently lead to the decrease in audit delay. Therefore, the first hypothesis is developed.

H_1: There is negative relationship between the audit committee independence and audit report lag.

2.2. Audit Committee Diligence

Ismail et al. (2008), measure audit committee diligence based on actual number of audit committee meetings held in a year. Audit committee meetings are considered as an important tool in ensuring audit committee members are fulfilling their responsibilities towards the company. Audit committee must carry out activities effectively through increased frequency of meetings in order to maintain its control functions (Bedard et al. 2004). Abbott et al. (2000) in their examination found that audit committee that meets at least twice annually is subjected to less exposure of sanction by the authorities. This is because regular meetings conducted would indicate that the audit committee discharges their duties in a well manner as an agent in the company. They also noted that audit committee that is wholly independent is also active by way of having meetings.

Dechow et al. (1996) argue that audit committee is an integral part of a company that emphasises high level monitoring. Moreover, the monitoring function would be more effective in terms of financial reporting. American Bar Association posits that an audit committee which holds less than 2 meetings annually is considered not committed to their duties. This indicates that the audit committee is unable to contribute to the internal control in that situation. Auditors who really monitor the internal control function of the company would reduce their works. However, Ismail et al. (2008) found that frequency of audit committee meeting could not influence the quality reporting of the companies. They argue that this is due to the companies only fulfilling the requirements, rather than the impact of the requirements.

Razman and Iskandar (2004) found Malaysian companies that have good reporting meet more frequent than poor reporting companies. This is because, during the meeting, they can monitor the management activities. Of consequence, this will lead to the decrease time taken on auditing by the auditors and reduce the reporting lag. Therefore, following hypothesis is developed.

$H_{2:}$ There is negative relationship between audit committee diligence and audit report lag.

2.3. Audit Committee Expertise

Audit committee expertise is important in order to deal effectively with external auditors. This is because audit committee typically acts as the mediator between the management and the auditors. DeZoort et al. (2003) note that audit committee members with experience in financial reporting and auditing especially those who are CPAs would understand auditors’ tasks and responsibilities. They would become more supportive of the auditors compared to audit committee members who do not have similar experience. Audit committee members who are experts are more ‘friendly’ with the auditors, comprehensible, logical and coherent when they are discussing with the auditors regarding the financial reporting of the company.

Audit committee with more expertise would be more concerned about the financial reporting quality of the company. DeZoort (1998) contends that an audit committee with more internal control experience makes decisions or judgments similar to auditors compared to those audit committee members who are without experience. This reflects that experience in the accounting, internal control or auditing is fundamental to enable the audit committee to understand and cater on the problematic issue on the financial reporting system of the company. They would also realise the benefits of producing financial statement on time at the market.

It is also identified that audit committee with financial expertise are going to facilitate each other. As discussed in resource based theory, the resources and capabilities that audit committee posses with financial expertise may assist in improving the firm performance.

Listed companies in Malaysia that have financial literate members of audit committee would have ability to end up with good financial report (Razman and Iskandar, 2004). This is because audit committee who has knowledge in accounting and auditing is able to demonstrate their ability in monitoring of internal control and reporting. Strong internal control also would lead the auditors in reducing their work because of their reliance on the credibility of the internal control. Therefore, the following hypothesis is developed:

$H_{3:}$ There is negative relationship between the audit committee expertise and the audit report lag.

3. Research Design

Sample covered in this study are among 288 companies listed at Bursa Malaysia for three years from 2007 to 2009. The samples are chosen randomly from 806 of the population.

Table 1: Total number of companies and sample based on industry

Industry	Population	Sample of companies	Percent
Construction	49	19	7
Consumer	139	53	18
Hotel	5	2	1
Industrial	265	88	30
Infrastructure	7	3	1
Property	88	31	11
Plantation	43	16	6
Technology	29	12	4
Trading & services	181	64	22
TOTAL	**806**	**288**	**100**

The companies listed at Bursa Malaysia are selected for this study because they are governed by the rules and regulations imposed by MCCG and Bursa Malaysia Listing Requirements. The companies selected include consumer, industrial products, trading and services, construction, infrastructure, hotel, property, technology and plantation. Table 1 provides the number of companies selected from each of the sector.

There are seven operational variables which comprise of one dependent variable, three independent variables and three control variables as describe in Table 2.

Table 2: Variables Measurements

Variables	Definition	Measurement
Dependent ARL	Audit report lag	Represents the number of days elapsing between the end of the fiscal year of the company to the completion of the audit for the current year for each individual firm (the audit report date)
Independent ACIND	AC independence	Percentage of non-executive directors to the total of audit committee members
ACMEET (ACdiligence)	AC meeting	Number of audit committee meeting
ACEXP (AC experience)	AC expertise	No of audit committee member with background experience in financial reporting (such as MIA,MICPA) to the total of audit committee members.
Control SIZE	Company size	Natural log of year end total assets
AUDIT TYPE	Type of audit firm	Dummy variable, '1' if auditor is one of the former Big-4 audit firms, '0' otherwise
PROF	Profitability	PROF = Return on asset, measured by net income divided with total assets

4. Results

4.1. Descriptive Statistic

Table 3: Descriptive Statistics for Audit Report Lag (N= 288)

Year		N	Minimum	Maximum	Mean	Median
2007	ARL	288	40.00	184.00	103.14	110.50
2008	ARL	288	40.00	146.00	103.42	111.00
2009	ARL	288	36.00	136.00	102.46	110.00
2007- 2009	ARL	864	36.00	184.00	103.00	111.00

Notes: ARL = number of days between the end of the fiscal year to the date of completion of audit

As shown in Table 3, the mean score of audit report lag for the pooled sample is 103 days with a maximum and minimum days of 184 and 36 respectively. This indicates that on average, the companies took 103 days to complete their audit report. Using the pooled sample from period from period 2007 to 2009, the results indicate that the companies did comply with Bursa Malaysia listing requirements and the Companies act where they submit their report within six months except for one company which took 184 days to submit the report. It shows that companies are improving over the years on the number of days taken to complete the annual reports. The results of this study are somewhat similar to Afify (2009) that found the maximum and mean score number of days to complete the annual report was 115 days and 67 days respectively. The results indicate that the number of days that the companies took to complete the audit report has reduced from 2007-2009 by 48 days.

Results on previous study show relative difference with the current study. Che-Ahmad and Abidin (2008) found that 442 days while Ahmad and Kamarudin (2003) reveal 273 days on the maximum of days to complete the annual report.

Table 4: Number of companies and audit report lag for 2007 – 2009

Audit report lag ARL (within)	**No. of companies**		**No. of companies**		**No. of companies**	
Year / percentage	**2007**	**Percent**	**2008**	**Percent**	**2009**	**Percent**
1 month (30 days)	0	0.00	0	0.00	0	0.00
2 months (60days)	22	7.64	20	6.94	25	8.68
3 months (90days)	42	14.58	41	14.24	41	14.24
4 months (120days)	198	68.75	211	73.26	208	72.22
5 months (150days)	25	8.68	16	5.56	14	4.86
6 months (180days)	0	0.00	0	0.00	0	0.00
More than 180days	1	0.35	0	0.00	0	0.00
Total	**288**	**100**	**288**	**100**	**288**	**100**

Table 4 shows that for the three year period, no company has completed and submitted their annual report within a month. The results also show that for the three year period, 41 to 42 companies have completed and submitted their annual report within 3 months. None of the companies have submitted their audit reports exceeding 6 months except for one company which managed to submit their audited report only after 184 days in year 2007.

The results in Table 4 shows that most companies reports way ahead the date stipulated by Chapter 9 (9.23a) of Bursa Malaysia Listing Requirement that the annual report shall be issued and submitted within a period not exceeding 6 months from the financial year end of the company. Such results indicated that the companies are concerned and realised that audited reports are useful for users' decision-making. The results support the notion that excessive delay in publishing financial statements would increase uncertainty in relation to investment decisions (Ashton et al. 1987; Ahmad and Kamarudin, 2003).

Table 5: Descriptive statistic for Audit Committee Characteristics and Control Variables

Independent Variable	**N**	**Minimum**	**Maximum**	**Mean**	**Median**	**Std. Deviation**
ACIND	864	0.60	1.00	0.93	1.00	0.18
ACDIL	864	1.00	12.00	4.84	5.00	1.67
ACEXP	864	0.00	1.00	0.40	0.33	0.19
Control variable						
SIZE TOTASSET (RM BILLION)	864	9^{-3}	36.64	0.79	0.24	2.86
TYPEAUD	864	0	1	0.58	0.00	0.49
PROFITABILITY	864	-1.88	11.059	0.03	0.03	0.40

Notes:
ACINDP = percentage of non-executive directors to the total of audit committee members
ACDIL = number of audit committee meeting
ACEXP = no of audit committee member with background experience in financial reporting
TOTASSET = total assets that the companies have at the end of the financial year.
TYPEAUD = '1' if audited by Big-4, '0' if otherwise
PROFITABILITY = net income divided with total assets

Table 5 presents the characteristics of the audit committee among the listed companies. The results show that audit committee independence (ACIND) has a mean score 93 percent. The results also show that the listed companies minimum score of 60 percent of their audit committee member being represented by independent directors. The results indicate that the companies comply with the Bursa Malaysia listing requirement (2009) which requires a company to have majority of the audit committee members being independent directors. Although the requirement of Bursa Malaysia on the number of independent directors in a board of directors is different from MCCG's (2007) requirement, the requirement of Bursa Malaysia listing requirement prevails MCCG's requirements[2].

Table 5 also presents the results on the number of meetings held by the audit committee. The results show that almost all audit committee in the listed companies discharge their duties appropriately in which on average 5 meetings were being held. The highest number of meeting held by the audit committee during the three year period was 12 times. MCCG (2007) provides that companies should have their audit committee meeting at least 4 times a year.

Table 5 also shows the mean score of audit committee expertise (ACEXP) as 0.4 (40 percent). Such results indicate that most audit committee in the listed companies have audit committee members with experience in financial reporting. Only 24 of the companies (2.78 percent) formed their audit committee with members not having accounting qualification. The later results did not comply with requirements of Bursa Malaysia listing requirements and MCCG that states at least one member of the audit committee must fulfill the financial expertise requisite. In fact, two companies for the three year period have yet to comply with the requirement to have one of the audit committee members' with financial expertise.

4.2. Correlation Matrix Analysis

Table 6 shows a non-significant value (0.333) which is more than 0.05, indicating data normality. Based on Kolmogorov-Smirnov and Shapiro Wilk tests, this study concludes that audit report lag is normally distributed.

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[2] MCCG (2007) provides that, all members of the audit committee should be non-executive directors.

Table 6: Normality Test for Audit Report Lag

	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
NARL	0.034	864	0.021	0.998	864	0.333

a. Lilliefors Significance Correction

Table 7 shows no correlation problem among the variables since the value is less than 0.5. The variance inflation factor (VIF) indicates all variables have a value below two which is within the acceptable range of 10.

Table 7: Correlation Matrix Table

	ARL	ACDIL	ACIND	ACEXP	Log_Asset	TYPEAUD	ROA
ARL	1						
ACDIL	0.096**	1					
ACIND	-0.068*	0.030	1				
ACEXP	-0.019	0.022	0.013	1			
LOG_ASSET	-0.170**	0.093**	0.078*	-0.003	1		
TYPE AUD	-0.170**	-0.088**	0.010	-0.021	0.195**	1	
ROA	-0.076*	0.033	0.029	-0.032	-0.021	0.006	1

**Correlation is significant at the 0.01 level (2-tailed).* Correlation is significant at the 0.05 level (2-tailed)

Notes:

ACINDP = percentage of non-executive directors to the total of audit committee members
ACDIL = number of audit committee meeting
ACEXP = no of audit committee member with background experience in financial reporting
LOG_ASSET = natural log of total assets (in billions of ringgit Malaysia)
TYPEAUD = '1' if audited by Big-4, '0' if otherwise
ROA = net income divided with total assets

4.3. Fixed Panel Regression

This section presents the results of the fixed panel regression using Eviews. The panel data analysis is an increasingly popular form of longitudinal data analysis among social and behavioral science researchers (Hsiao, 2003). A panel is a cross-section or group of people who are surveyed periodically over a given time period. In this study, the group is the listed companies selected and the time is the duration of the data collected, which is the three year period of 2007 until 2009. Since the data is bound to be heterogeneity, the panel data technique could take such heterogeneity explicitly into account by allowing individual specific variables (Gujarati, 2003). Normal regression does not adjust firm's specific effect which would lead to variables being omitted and mis-specified the model (Fraser et al. 2005). Fixed effect model could overcome such problem by adjusting the effects through firm's specific intercept by capturing immeasurable firm's specific characteristics (Fraser et al. 2005). Panel data provides more informative of data, variability and efficiency. Under the panel data, the model is generated as follows:

$$ARL = \beta_1 ACINDP + \beta_2 ACMEET + \beta_3 ACEXP + \beta_4 SIZE + \beta_5 AUDTYPE + \beta_6 PROF + \varepsilon\ it$$

Table 8: Fixed Panel Regression Result

Variable	Coefficient	Prob.
ACIND	-0.021706	0.001*
ACDIL	-0.009835	0.899
ACEXP	-0.040084	0.001*
LOG_ASSET	-0.129782	0.012*
ROA	-0.002146	0.264
TYPEAUD	0.002535	0.294
C	5.786734	0.000
N	864	

Table 8: Fixed Panel Regression Result - continued

Adjusted R-squared	0.802562	
F-statistic	12.811	
Prob(F-statistic)	0.000	

Notes:

ACINDP = percentage of non-executive directors to the total of audit committee members
ACDIL =number of audit committee meeting
ACEXP = no of audit committee member with background experience in financial reporting
LOG_ASSET = natural log of total assets (in billions of ringgit Malaysia)
TYPEAUD = '1' if audited by Big-4, '0' if otherwise
ROA = net income divided with total assets
Adjusted R^2 = adjusted R^2 coefficient determination
F stat = indicate how much variation is explained by the regression equation.
*significant at 1%.

Table 8 shows that the audit committee independence (ACINDP) and audit committee expertise (ACEXP) are significant at 1% level. Thus, accepting hypotheses one and three respectively. On the other hand, the results show that there is no relationship between audit committee diligence and audit report lag. Therefore, hypothesis two is rejected.

The results indicate that audit committee independence and audit committee expertise may reduce on audit report lag but audit committee diligence could not influence audit report lag. Carcello et al. (2000) found that audit committee independence and audit committee expertise have significant relationship with audit fee while audit committee diligence did not provide any relationship on audit fees.

The results in this study shows significant relationship between audit independence and audit report lag which is similar to Klein (2002) that found that more independent audit committee members would effectively influence financial reporting quality. The results of this study support the view that audit committee with a simple majority of independent audit committee members are more likely to fulfill its duties effectively compared to an audit committee members that have no independent audit committee members. This is consistent with agency theory where independent members in an audit committee could assist principals to monitor the agents' activities and reduce benefits from withholding information. They would have had provided more effective roles in monitoring the companies.

Further, the number of financial experts on audit committee will reduce incident of fraud (Farber, 2005). A member with financial expertise demonstrate a high level of financial reporting knowledge and thus expected to lead the committee, identify and ask knowledgeable questions that challenge management and external auditor (He et al. 2009).

In practice, it is a general belief that more meeting and discussion of the committee would improve the performance of the company. However, similar to the study done by Uzun et al. (2004), the results in this study show that the number of audit committee meeting held is not significantly associated with audit report lag. More frequent meeting that the company has does not necessarily provide better achievement to the companies. Thus, the company needs to ensure audit committee member raised and resolved issues with management during the meeting, and as a result improve the quality of reporting.

5. Conclusion

The results of this study show that audit committee characteristics: audit committee independence and audit committee expertise contribute as important factors that affect audit report lag of the companies. Such results correspond to the resource based theory where those characteristics of audit committee as the resources and capabilities that may improve companies' performance as well as on the corporate reporting. These two characteristics represent the Bursa Malaysia listing requirement that require audit committee compose of not fewer than 3 members with majority of them being independent directors and requires at least one member of the audit committee to have financial expertise requisite. Audit committees with those characteristics could assist the companies to be timely in their annual reporting.

Finally, this study could not find significant link between audit committee meeting to audit report lag. This study suggests that audit committee could prioritise important things that need to be resolved during the meeting in order to improve the performance of the company as well as in assuring audit report lag.

This study is not without limitations. This study does not include other factors such as government policy or political issue that also might affect audit report lag. McGee (2007) noted that the influence of timeliness might be attributed by culture, political and economic system of the country. Secondly, covering a bigger sample would provide greater generalization on the Malaysian listed companies on audit report lag and corporate governance characteristics. Finally, this study only covers a three year period from 2007 until 2009. A longer period such as ten year period data would be more interesting as it can show the trend on audit report lag. For future research avenues, a possibility is to examine other corporate governance mechanisms; characteristics of board of directors in assuring audit report lag. Future research can also examine which parties are liable for the delay of annual report, either on the hands of the preparers or auditors.

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